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June 25, 2003

Ms. Sara Kyle, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges So As to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful In Furnishing Water Service to Its Customers, Docket No. 03-00118.

Dear Chairman Kyle:

Pursuant to the April 25, 2003 order of Director Ron Jones acting as Pre-Hearing Officer in this docket, this is to advise all parties that Petitioner Tennessee American Water Company ("TAWC") intends to use the following exhibits at the hearing of this matter:

1. All exhibits attached to the direct and rebuttal testimony of its witnesses;
2. The notice of hearing published and posted pursuant to Rule 1220-4-1-.05 of the Rules of the TRA and T.C.A. § 65-5-201 (which will be filed and served on Friday, June 27, 2003);
3. Transcript of Excerpt of Directors' Conference, Tuesday, January 11, 2000, with respect to Docket No. 99-00891; and
4. Order Approving Tariff, dated September 26, 2000 (and dissenting opinion of Director Greer, in Docket No. 99-00891.

Copies of the foregoing have been or are being provided to all parties, except for item 2, which will be provided on Friday.

Best regards.

Very truly yours,



R. Dale Grimes

RDG/ts

Chairman Sara Kyle

June 25, 2003

Page 2

cc: Certificate of Service List (with enclosures)
Mr. William F. L'Ecuyer (via facsimile)
Mr. Michael Miller (via facsimile)
Mr. Roy Ferrell (via facsimile)

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing letter has been served, via the method(s) indicated, on this the 25th day of June, 2003, upon the following:

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☒ Overnight

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June 25, 2003

Ms. Sara Kyle, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Re: *Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges So As to Permit It to Earn a Fair and Adequate Rate of Return on Its Property Used and Useful In Furnishing Water Service to Its Customers, Docket No. 03-00118.*

Dear Chairman Kyle:

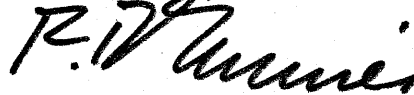
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1. All exhibits attached to the direct and rebuttal testimony of its witnesses;
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June 25, 2003

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P. J. Hines

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LEGAL NOTICE OF HEARING

Notice is hereby given that Tennessee American Water Company (the "Company") filed a petition and tariffs with the Tennessee Regulatory Authority, on February 7, 2003, asking that it be permitted to change water rates currently being charged in the areas being served by the Company. The Company's proposal would increase its annual revenues by approximately \$3,866,813, an increase in annual revenues of 12.7%. The proposed tariffs filed by the Company increase water rates across the board.

The proposed rates as filed are those proposed by the Company and the Tennessee Regulatory Authority may in some or all instances adopt, reject, increase, or decrease said proposed rates, in part or in whole. The petition was filed to establish water rates that will enable the Company to earn a fair return on its investment, prevent impairment of its credit, meet its obligation to its customers, employees and creditors and to preserve its property. A copy of the proposed tariff changes and the reasons for them are on file with the Tennessee Regulatory Authority and are open to public inspection.

The matter will be heard before the Tennessee Regulatory Authority on Monday, June 30, 2003, at 9:00am (CST), at the Tennessee Regulatory Authority, Main Hearing Room, at 460 James Robertson Parkway, Nashville, Tennessee. This notice is being given pursuant to Rule 1220-4-1-.05 and Tennessee Code Annotated 65-5-201.

William F. L'Ecuyer
President
Tennessee American Water Company

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

September 26, 2000

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IN RE:

TARIFF FILING TO REDUCE FIRE HYDRANT
ANNUAL CHARGES AS PART OF A
SETTLEMENT AGREEMENT BETWEEN
THE CITY OF CHATTANOOGA AND
TENNESSEE-AMERICAN WATER COMPANY

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)
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) DOCKET NO. 99-00891
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ORDER APPROVING TARIFF

This matter came before the Tennessee Regulatory Authority (the "Authority") at the regularly scheduled Authority Conference held on January 11, 2000 for consideration of the tariff filing (the "Tariff") of Tennessee-American Water Company (the "Company"). The Company filed its Tariff on November 17, 1999 with an effective date of December 17, 1999. At the December 7, 1999 Authority Conference, the Authority suspended the Tariff for thirty (30) days, through January 15, 2000. The Company filed this Tariff as a part of its compliance with a Settlement Agreement (the "Agreement") entered into on October 25, 1999 between the Company and the City of Chattanooga (the "City").¹ In accordance with the Settlement

¹ The Agreement contains the terms of a settlement of a condemnation lawsuit, *City of Chattanooga v. Tennessee-American Water Company et al.*, Case No. 99-C-1081, Circuit Court of Hamilton County, Division IV. Section 2.B of the Agreement states as follows:

[The Company] and the City will file a joint petition with the Tennessee Regulatory Authority ("TRA") seeking permission to reduce over a two-year period the current charge of \$301.00 a year per fire hydrant to \$50.00 a year per fire hydrant at the end of that period. If the TRA does not approve this provision, then this section is null and void.

Agreement, the Company submitted its Tariff, designated as the Fifth Revision of Sheet No. 8 of its TPSC (Tennessee Public Service Commission) Tariff No. 19, to the Authority for approval.

While Settlement Agreements are often encouraged as a mechanism for parties to resolve amongst themselves what may otherwise remain as contestable issues, the joint presentation of such an Agreement does not in any way diminish the Authority's duty to ensure that tariffs are filed in accordance with state law and are consistent with the public interest. Consequently, the Authority considered only the merits of the Tariff as filed by the Company.²

According to its proposed Tariff, the Company will decrease, in quarterly reductions, its annual charges to the City for each fire hydrant from the current rate of \$301.20 to a rate of \$50.00. The first such reduction is to be effective December 31, 1999, with the final reduction taking effect December 31, 2001. The Company currently provides 4,491 fire hydrants to the City and several nearby areas.³ According to Tennessee-American Water Company, its proposed Tariff, after the final reduction has taken place, results in an annual revenue impact of negative \$1,127,964.⁴

The instant concern to the Authority in considering this Tariff is the immediate and material lost contribution that would result upon approval of this Tariff. It is clear that in order to afford the Company the opportunity to achieve its presently authorized return that either revenue streams from other sources must be increased⁵ or the company and its stockholders must

² The Authority notes that the Settlement Agreement was solely between the Company and the City of Chattanooga, and the Authority's consideration, consistent with state law, of this Tariff filing would remain unchanged absent such an Agreement.

³ The Company provides public fire hydrant service to the City of Chattanooga, the City of East Ridge, the City of Red Bank, the Town of Lookout Mountain, and unincorporated areas of Hamilton and Marion Counties, as well as the City of Rossville, Georgia, the Town of Lookout Mountain, Georgia, and unincorporated areas of Walker, Catoosa, and Dade Counties, Georgia.

⁴ Company's Response to Authority Data Request, December 20, 1999, Attachment A.

⁵ This can be achieved in a number of ways including adding more customers, increasing rates, etc . . .

agree to absorb the shortfall.⁶ While not the Authority's primary consideration in evaluating this Tariff, it is worth noting that the Settlement Agreement purports to benefit local taxpayers by approximately \$1,000,000 per year. Interestingly, even if the City of Chattanooga flowed through the full \$1,000,000 to the existing ratepayer body, the potential that a net contribution loss would remain may not be entirely eliminated. In effect, Chattanooga taxpayers could potentially be better off while Chattanooga ratepayers could potentially be worse off.

The Authority is mindful that the Company acts on behalf of itself and its stockholders and the two cannot, for our purposes, be deemed severable. To hold otherwise would place the Authority in the unenviable position of "knowing" better than does the Company what is in its best interests. This is particularly apropos in instances, as is the case here, where a settlement is involved. Here, William F. L'Ecyer, President of Tennessee-American Water, represented the Company and stockholders; and, Mayor Jon Kinsey represented the City of Chattanooga.

Both Tennessee-American Water Company's legal counsel and Mr. L'Ecyer, on behalf of the Company and stockholders, represented that the Company intended to recover the lost margin resulting from the approval of this Tariff by increasing sales of water to existing customers and by gaining new customers. Additionally, Mr. L'Ecyer further stated that any expenses incurred by the Company in litigation defense would not be borne by its ratepayers but rather by the stockholders of the American Water Works Company. The Company, furthermore, states that approval of a rate reduction for the City of Chattanooga, will somehow translate into an opportunity to become more competitive and efficient, thereby ultimately resulting in ratepayer benefits. Finally, as noted above, the City of Chattanooga urges approval based on an estimated potential \$1,000,000 annual saving.

⁶ In this instance, lost revenues attributed to this Tariff filing would be imputed into the Company's subsequent rate filings, thus reflecting the Company's and stockholders' decision to absorb the contribution loss.

While it is not absolutely necessary to envision the totality of the potential long-term benefits attendant to approving a \$1,127,964 reduction in contribution in this instance, it is clear that the Company considers itself to be making a sound business decision that it is convinced will likewise yield future ratepayers benefits. The Company (and stockholders) memorialized its conviction by stating its intention to limit margin loss recovery in a manner that has no effect on today's or future rates. The Authority does not, nor is it within its purview to do so, question the prudence of the Company's or its stockholders' assessment of risk or reward to the Company in deciding to seek approval of this Tariff filing.⁷ It is, furthermore, recognized that a Tariff filing containing potential, long-term benefits while producing no immediate or long-term injury is clearly within the public interest; and, additionally nothing was identified herein in contravention of state law.

After hearing the statements presented by the Company and the City, a majority of the Directors determined that the Tariff should be approved. The majority, furthermore, ordered, consistent with the Company's representations, that the loss of revenue resulting from rate reductions to the City of Chattanooga be borne by the Company's stockholders and not by the Company's ratepayers, either now or at any time in the future.⁸ In approving this tariff, the Authority recognizes that the Company has voluntarily reduced its rates as part of its Settlement Agreement with the City of Chattanooga. Therefore, given the facts in this instance, as discussed

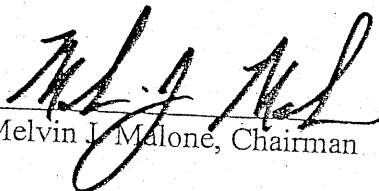
⁷ The Company's shareholders, of course, do have recourse from what they may perceive to be an imprudent management decision. Owners may simply decide to reconfigure management or pursue other remedies. Nevertheless, remedial cures resulting from improvidence is the unique responsibility that exists between owners and management alone.

⁸ Director Greer voted not to approve the Tariff. Director Greer did, however, state, "I do strongly agree though with . . . Chairman Malone's portion of his motion that says that he believes the ratepayers should not bear any cost in any future rate case. I strongly support that decision." Transcript of Authority Conference, January 11, 2000, at 27.

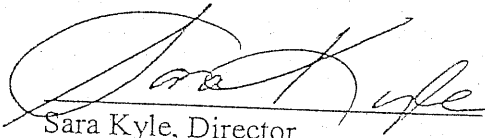
above, the Authority, consistent with the Company's representations, does not deem it appropriate that this voluntary contribution loss be recoverable from ratepayers.

IT IS THEREFORE ORDERED THAT:

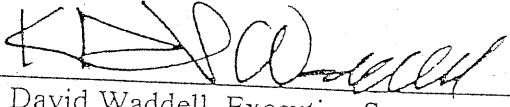
1. The Tariff filing of Tennessee-American Water Company to reduce fire hydrant annual charges is approved;
2. The lost contribution to Tennessee-American Water Company resulting from the reduction in fire hydrant charges along with any expenses incurred as a result of the underlying litigation with the City of Chattanooga shall be borne, in full, by the stockholders of Tennessee-American Water Company;
3. The Company's ratepayers shall not at any time, through increases in rates, fees, schedules, or otherwise, bear any of the cost resulting from this Tariff filing by Tennessee-American Water Company to voluntarily reduce its fire hydrant charges to the City of Chattanooga.


Melvin J. Malone, Chairman

H. Lynn Greer, Jr., Director


Sara Kyle, Director

ATTEST:


K. David Waddell, Executive Secretary

*** Director Greer did not vote with the majority and is filing a separate dissent which is attached to this Order.

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Docket No. 99-00891

DISSENTING OPINION OF DIRECTOR GREER

Since its inception, the Tennessee Regulatory Authority (the "Authority") has endeavored to balance the interests of consumers and utilities. In this case, several factors complicate and frustrate this balancing act. In its tariff filing, counsel for Tennessee American Water Company (the "Company"), states that "[t]he Company believes that the settlement of the lawsuit and the reduction of the fire hydrant charges over a two-year period as proposed in the tariff are necessary and proper and in the best interest of the Company and the customers it serves." Despite this assurance, I am not convinced that this tariff is necessary, proper, or in the best interest of the Company or its customers.

Under rate of return regulation, to which the Company is subject, most tariff applications to lower rates are filed when a utility is responding to a threat of by-pass or some other competitive threat. In those types of cases, the interests of both the utility and its customers are best served by a rate reduction if the reduction is sufficient to retain a customer with competitive

supply options and if that customer represents a significant share of the utility's revenues that otherwise could not be recouped easily.

Here, in contrast, the Company's tariff to lower rates is not a response to a competitive threat in the traditional sense, but rather is part of the settlement agreement to a lawsuit in which the City of Chattanooga (the "City") was seeking to purchase the Company.¹ This tariff reduces the fire hydrant rates paid by the City, which will reduce the Company's revenue by \$1,127,964. Relative to the Company's current revenues, this is a substantial reduction. In addition, the settlement agreement provides that the company will pay its own litigation expenses, and cooperate with the City in efforts to improve the City's fire rating.

To recoup revenue, a company must increase its revenue in excess of any additional expenses, including the expenses incurred to increase revenue. In describing its anticipated plan for recouping the lost revenue from this tariff, the Company claims it "has experienced and anticipates additional growth that will potentially offset a portion of the proposed rate adjustment."² (Emphasis supplied.) This statement clearly falls short of an assurance that this tariff will not create a financial strain for the Company. Moreover, although the Company states that it has budgeted funds to improve the City's fire rating,³ these improvements will create new and additional costs to the Company. Thus, although the Company has been ordered, with my support,⁴ to force its shareholders to bear the lost revenue from this settlement, the Company's

¹ Unfortunately, the parties' filings in this docket do not present the merits of the lawsuit that produced the settlement.

² See the Company's response to Authority Data Request, December 20, 1999, at 1. See also Transcript of Authority Conference, January 11, 2000, at 17-19.

³ Transcript of Authority Conference, January 11, 2000, at 23.

⁴ Regardless of the merits of the dispute between the City and the Company, part of the investment risk facing the company's shareholders involves the potential for lawsuits such as the one precipitating this settlement. In this case, given the legal limitations on what the Authority can require of the City, I support the Authority's decision to require the Company's shareholders to bear the cost of this settlement agreement and the proposed tariff filing. Nonetheless, I am concerned that the shareholders are being forced to bear some costs that are more appropriate for the City to bear.

ratepayers ultimately may pay higher rates at least partly as a result of this settlement.⁵

Without information about the bargaining posture of the City and the Company, it appears that many, if not all, of the terms of the settlement agreement could have been reached outside of a condemnation lawsuit. After all, the settlement provisions other than those in the tariff largely seem to benefit both the City and the Company. Assuming that less costly negotiations could have produced the same results, the lawsuit and the related actions of the City and the Company created socially wasteful costs in addition to the actual and potential costs discussed above. Moreover, fairness and efficiency generally dictate that "cost causers" should shoulder the costs they create. Thus, the problems previously mentioned are exacerbated to the extent that the City, as a principle cost causer in this matter, will not shoulder an appropriate share of the socially wasteful costs it has created.

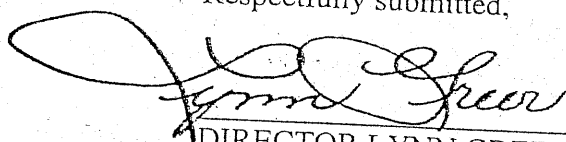
Significantly, the settlement agreement provides that if the fire hydrant rate reduction is not approved by the Authority, "the remainder of the agreement shall remain in full force and effect."⁶ Further, when given the opportunity at the January 11, 2000 Authority Conference to discuss hypothetically the ramifications of the Authority denying approval of the tariff, neither the City nor the Company represented that there would be any repercussions had the Authority denied approval of the tariff.⁷ Nonetheless, the City and the Company – entities dedicated to serving many of the same consumers – reached an agreement, part of which was approved by the majority's decision. I encourage them to respect the majority's decision by cooperating in order to create revenue growth and cost efficiencies for the Company so that benefits from the settlement may accrue to both the Company and its customers. Unfortunately, however,

⁵ Unless a higher court provides definitive directions on how to treat the lost revenues from this settlement, the issue of the lost revenues will likely be argued in future rate cases brought by the Company. Regardless, the Authority's eternal vigilance likely will be required to ensure that the Company's ratepayers ultimately do not shoulder the burden of the lost revenues.

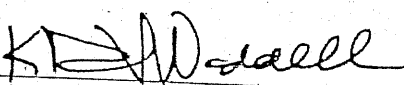
ensuring such cooperation is largely beyond the Authority's control.

In sum, the challenge presented by this and every other case before the Authority is rendering a decision that balances the interests of both the utilities and their customers. For the foregoing reasons, it is my opinion that approval of this tariff is not necessary or proper; and does not best serve the interests of the Company or its customers.⁸ Therefore, I respectfully disagree with the majority's decision.

Respectfully submitted,


DIRECTOR LYNN GREER

ATTEST:


David Waddell, Executive Secretary

⁶ Settlement Agreement between the City and the Company, October 25, 1999, at 2.
⁷ Transcript of Authority Conference, January 11, 2000, at 26.

⁸ It is interesting to note a possible ambiguity contained in the Order approving this tariff. On the third page, the Order states, "In effect, Chattanooga taxpayers could potentially be better off while Chattanooga ratepayers could potentially be worse off." (Emphasis supplied.) Meanwhile, the next page contains this cryptically generic comment: "It is, furthermore, recognized that a Tariff filing containing potential, long-term benefits while producing no immediate or long-term injury is clearly within the public interest; and, additionally nothing was identified herein in contravention of state law." (Emphasis added.) If "a Tariff" refers to the tariff at issue, the latter quote seems inconsistent with the former, unless Chattanooga ratepayers are not assumed to be among those avoiding immediate and long-term injury in the latter quote. If, on the other hand, "a Tariff" does not refer to the subject tariff, the latter quote provides little substantive support for the majority's decision. Thus, with respect to the net effects of the subject tariff, the majority who approved this tariff may share some of my uncertainty, but apparently not my level of concern for that uncertainty.